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C O N F I D E N T I A L SECTION 01 OF 03 SOFIA 000122

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TAGS: [PGOV](#) [PREL](#) [ECON](#) [BU](#)
SUBJECT: BULGARIA, FEELING THE HEAT, WILL CLOSE DUTY-FREE
SHOPS

Classified By: Amb. J. Beyrle for reasons 1.4 (b) and (d).

11. (C) SUMMARY: In response to a pressure campaign organized by the Embassy (abetted by the EU and Bulgarian NGOs) the government announced on February 10 that it will close duty-free shops and gas stations on external borders, long acknowledged as a notorious source of "protected smuggling" here. The announcement comes on the heels of the Parliament's decision to rescind tax breaks for casinos, again in response to Embassy/NGO pressure. We are pushing the government to implement its decision in the face of mounting pressure from the Duty Free Operators Association -- the front men for the criminal groups that control the duty-free trade, who have enjoyed political protection until now. And we are stepping up efforts on our next agenda item -- bringing greater transparency to cash transactions by closing a loophole in anti-money laundering legislation. END SUMMARY.

DUTY-FREE SHOPS FUNDING GRAY ECONOMY

12. (SBU) Duty free trade-related smuggling of excise goods (particularly cigarettes, alcohol, and petrol) has been a major funding source for the gray economy for the last fifteen years. Attempts to close down or regulate and collect taxes from duty-free shops and gas stations operating at Bulgaria's land borders have repeatedly been stymied by political opposition tied to pressure from well-connected "businessmen." Bulgaria's January 2007 EU accession mandated the country close duty-free shops and gas stations operating at Bulgaria's borders with neighboring EU countries. In 2006 the Bulgarian Parliament granted permanent licenses for duty-free trade to all existing operators, and allowed them to relocate businesses to Bulgaria's external non-EU borders. A substantial portion of excise goods sold at duty-free shops and gas stations stays within the country, however, and avoids taxation. A Bulgarian think-tank describes this scheme as "protected smuggling," which results in significant losses for the state budget, and unfair competition for legitimate businesses. It is widely believed that the network of duty-free shops in Bulgaria facilitates other crimes, including fuel smuggling, forced prostitution, the

illicit drug trade, and human trafficking. There are also credible allegations that profits from duty-free sales feed political party coffers, and that the ultimate ownership of the shops is concentrated in a few, well-connected hands.

13. (SBU) During a December 12 NGO-sponsored public event on organized crime, Ambassador Beyrle singled out duty-free shops and gas stations as a funding source of political corruption and organized crime -- urging other Missions, private Bulgarians, civil society experts, and government officials to join forces to bring them into compliance with EU norms. Embassy officials stepped up the pressure on duty-free shops through op-eds, TV appearances, and public statements, in pre-arranged collaboration with local NGOs, and other Western European Embassies to bolster public support. The Ambassador also personally raised the issue with Prime Minister Stanishev twice, giving him data showing the duty-free trade was costing the country over \$250 million annually.

SPURRING THE GOVERNMENT TO ACTION

14. (SBU) The results of this pressure campaign began to show just prior to the release of the EC's highly critical monitoring report. Interior Minister Rumen Petkov told the press January 27 that he was in favor of eliminating all duty-free shops except those at the airports. On February 3, tipped off about the coming EC report's critique, European Affairs Minister Gergana Grancharova also took a firm public stance against the duty-free shops. The February 4 report criticized Bulgaria's lackluster efforts in curbing

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corruption and organized crime, and identified duty-free shops as "a focal point" for these problems. The report spurred further debate in the Bulgarian media and government over the shops and stations. In the face of mounting media speculation and pressure from the United States and the EU, the coalition leaders -- Stanishev, Saxe Coburg Gotha, and Dogan -- publicly announced the duty-free shops' closure on February 10 at a meeting of the Coalition Council. On February 13, the Council of Ministers approved two amendments to the Duty Free Trade Law banning duty free stores at land border checkpoints. The amendments have yet to be formally submitted to Parliament.

15. (C) The Duty Free Trade Operators Association -- and the "shady" business interests they front for -- is mounting a tough rear-guard action against the closure. The association said it plans lawsuits against the government demanding considerable compensation for investments on the duty-free trade licenses, and that the closure will create an "international scandal." At a February 19 Anti-Corruption Commission meeting chaired by Interior Minister Petkov, EU ambassadors and the DCM kept the coals stoked for prompt Parliamentary action on tough legislation, and rapid enforcement. The Finance Minister Plamen Oresharski told Ambassador Beyrle February 26, however, that pressure to retreat from a total shut-down was increasing; Beyrle told him any retreat at this point would reinforce the view that in Bulgaria, the politicians feared the criminals, and not vice-versa.

TAX BREAKS FOR CASINOS DEFEATED, CASH PAYMENTS ARE NEXT

16. (SBU) The Bulgarian government's decision to close the duty-free shops comes on the heels of the Parliament's rejection of a government proposal to amend the Corporate Tax Act to give tax breaks on gambling establishments. Pursuant to this decision, in 2008 the gambling tax remains at 10 percent for casinos and 12 percent on other games of chance. Leading think-tanks and commentators -- aided by the

Ambassador's criticisms on a morning TV talkshow --asserted that these breaks were designed to benefit a handful of individuals with shady ties. The public outcry against the proposal was rapid and dramatic, and helped shape our strategy against the duty-free stores.

17. (SBU) With tax breaks for gambling establishments defeated, and duty-free shops on their way to closure (we hope), we have now set our sights on a loophole in Bulgarian financial reporting. Bulgaria's anti-money laundering legislation requires financial institutions to report cash transactions over 30,000 leva (15,000 euro) to the Financial Intelligence Directorate (FID). The form used by banks for reporting these transactions does not include the actual amount of the transaction. The FID has identified this loophole as a key impediment to determining if cash transactions merit further investigation. According to the FID director, there were approximately 250,000 such transactions in 2007. The FID is unable to distinguish between transactions of 30,000 and 3 million leva. We see the closure of this loophole -- a simple administrative fix requiring only political will -- as key to improving Bulgaria's anti-money laundering efforts. The Chairman of the Bankers Association told us February 25 his group will not oppose a change in the regulation. The Minister of Finance is also on board. The road block remains the Central Bank, which states Bulgaria's money laundering legislation already exceeds EU standards. Using our multi-pronged action plan involving various mission elements, NGOs, and other like-minded embassies and GOB officials, we will target Central Bank resistance to the elimination of this loophole.

COMMENT

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18. (C) We and our EU co-conspirators will keep a sharp eye on the duty-free legislation and bolster public support to keep pressure on the government. The border shops are not yet shut down, and the huge money at stake will soon be brought to bear. In addition we, along with our partners -- Bulgarian NGOs and other embassies -- will continue work on closing the loophole to improve Bulgaria's anti-money laundering efforts. A recent editorial lamented that the government moves against corruption only because of outside pressure. Although not all positive developments are the result of outside pressure, recent successes achieved in tandem with local NGOs and other embassies are an essential component for the public to demand that the government make needed reforms. Bulgarians still depend, too often, on the United States and the EU to do pathbreaking work. But we do see signs they are shouldering more of the load. The key, as always, is political will -- and whether the government develops it on its own or we continue to shame them into it, we'll take it however it comes. End Comment.
Beyrle